

April 12, 2006

Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Attention: Ms. Jennifer J. Johnson
Secretary

RE: Docket No. OP - 1248

Dear Ms. Johnson:

We are a two bank holding company with a National charter and a non-member State charter operating in Virginia and West Virginia. We write to comment on the proposed guidance entitled *Concentration in Commercial Real Estate Lending, Sound Risk Management Practices* (the "Proposed Guidance").

Our first concern with the Proposed Guidance is it leaves examination teams with incredible discretion which could easily lead to inconsistent findings among banks engaged in similar activities. Perhaps more importantly, it leaves bank management with a good idea of what will be evaluated, but very little in terms of how compliance will be specifically measured and evaluated. The highly subjective nature of the Proposed Guidance causes us great concern in the way it could be imposed by the regulatory agencies. The Proposed Guidance needs to direct examination teams to consider how long a bank has been involved in commercial real estate lending, its historical losses, its geographic region, and the quality of its underwriting. The guidance should rely on these factors and make it very clear that exceeding a threshold does not automatically require an increase in regulatory capital levels.

Bank management and examiners need a clear understanding of any guidance or regulation. Two existing regulations address, clearly and concisely, issues related to real estate lending concentrations and capital adequacy:

- *The Real Estate Lending Standards* define supervisory loan-to-value limits and restricts loans in excess of the supervisory loan-to-value limits to 100 percent of capital with commercial real estate loans limited to 30 percent of capital.
- *The Risk Based Capital* regulations require 100 percent weighting for commercial loans under the assumption that this asset type exhibits a higher level of risk.

Under the Risk Based Capital regulations, higher levels of capital are allocated to the assumed riskier assets on the balance sheet. The Proposed Guidance suggests additional capital may be required relative to commercial real estate loan exposures, even if an institution is “well capitalized” in accordance with existing capital standards. However, the Guidance does not state or give any examples of the circumstances which would necessitate when or how much such additional capital would be warranted. If change to the minimum capital standards is needed, the change should be effected through the existing regulations, and not with new supplementary guidance.

Another concern we have in regard to the Proposed Guidance is the definition of commercial real estate loans. The definition is overly broad for both thresholds “construction, land development and other land” and “multifamily and nonfarm non residential properties”.

- Construction loans – Not all construction loans have the same risk profiles. In identifying concentrations, commercial and residential construction should be viewed separately, because their performance is not subject to similar economic or financial risks, especially if the residential construction has a firm purchase contract for the sale of the home. Even within the commercial construction sector, distinction for concentration purposes should be made between loans that have firm take-out commitments and those which do not.
- Land development loans – These loans have varying degrees of risk since some projects may have a guaranteed take-out versus a speculative market sale.
- Other land loans – Such loans are defined as vacant land but could include an unimproved residential lot held for investment or vacation property used for recreational purposes. This type of collateral is governed under the supervisory loan-to-value limits that require a maximum 65 percent LTV. Also, the repayment is derived from income of the consumer.
- Multifamily and non-farm non-residential property loan (where 50 percent or more of the source of repayments comes from third party, non-affiliated, rental income) – These two categories do not react to economic factors the same and placing these properties within the same category does not measure risk or reflect a concentration.

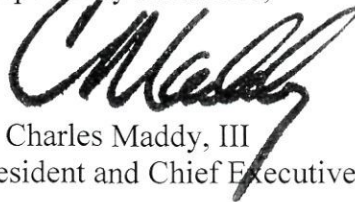
The Proposed Guidance excludes loans secured by owner occupied properties from the definition because their risk profiles are less influenced by the condition of the general commercial real estate market. We agree with the Proposed Guidance on this issue and believe this methodology should be applied to the aforementioned categories. To meet the concerns of the agencies and manage risk, the definition of CRE Loans should only include those loans that are dependent on the sale or rental income of the property. The definition should exclude construction loans where the property is pre-sold to a qualified buyer and is approved for long-term financing. The definition should also exclude land development where there is a guaranteed take-out by a qualified buyer. Other land should be excluded because of the limited LTV and the repayment is from income of the consumer.

The Proposed Guidance may force many institutions to discourage commercial real estate lending due to regulatory risk, and the result would be a significant shift in such lending from community banks to regional banks. This is especially disturbing given current trends of specialized asset generators dominating so many markets that used to belong to community banks. A shift like this could have unintended consequences, especially for the small business customer who currently relies on the flexibility of community banks to obtain credit. This will have unintended consequences far beyond the perceived risks of commercial real estate lending.

Finally, the Proposed Guidance will not only affect the competitiveness of community banks, but their existence depends upon a level playing field. In recent years community banks have had to shift their focus from auto lending, credit card, and residential mortgage lending due to captive finance companies and realtors which capture borrowers at the point of sale. We believe our local communities and the nation as a whole benefits from increased competition. This guidance will ultimately place a disproportionate amount of burden on the community banking industry which may lead to additional consolidation and reduced competition.

We believe that capital should only be governed by law and not arbitrary guidance; therefore, we urge the agencies to reconsider this proposal and rely on the risk based capital regulation to govern capital levels. If our cries are not heard and this guidance is ultimately issued, we urge at a minimum that any changes made be done so that it is clear what specifically will be expected from community banks in the ever changing regulatory environment.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'H. Maddy', written over the printed name and title.

H. Charles Maddy, III
President and Chief Executive Officer